GARNEAU INC.

ANNUAL REPORT 2003

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CORPORATE PROFILE

Garneau Inc.'s primary business is the application of high performance protective coatings and linings for oil and gas pipeline protection and additionally, the design and manufacturing of oilfield equipment for both domestic and international markets. During more than 30 years of operating experience, Garneau Inc. has developed significant expertise and innovative technology, and has maintained a long-term focus on continuously improving the pipe coating process with cost-effective, quality coatings. The Corporation had taken further steps to expand pipeline operations during the year 2002 by constructing a High Density Polyethylene Pipe ("HDPE") manufacturing line in the Camrose facility. Garneau Inc. is now capable of supplying their clients a full range of 2" – 6" HDPE for shallow low-pressure gas lines. A talented and effective management team provides the vision and experience for long-term profitable growth and increasing shareholder value.

Vision

We are a company that uses technology and innovation to provide the world with ingenious, high-quality products and services for the oil industry.

Mission

We provide our customers, partners and alliances with what they need, when they need it ... always.

Values

We value innovation and ingenuity, keeping our commitments to each other and our stakeholders, open and honest relationships, and conducting our business in a way that is a "win/win" for all who work with us.

Garneau Inc. is a public company with approximately 11.3 million shares issued and outstanding, trading on the Toronto Stock Exchange under the symbol GAR.

GARNEAU INC.

MESSAGE TO THE SHAREHOLDERS

To the Shareholders:

INDUSTRY OVERVIEW

Stronger Oil & Gas drilling activity during the year 2003 resulted in an increased demand for small diameter pipeline coating products in Western Canada, contributing to improved Corporation operating results for the fiscal year 2003.

Approximately 19,800 wells were drilled during 2003 and industry drilling forecasts project in excess of 20,000 wells to be drilled for the 2004 year. These forecasts are based on the current strong commodity pricing for Oil and Gas together with the continuation of shallow gas well projects in the robust Alberta economy.

Demand for Garneaus' small diameter coating products has historically been correlated to drilling activity with the Corporation poised to handle the potential demand created by the forecasted drilling activity.

International opportunities continue to exist, notwithstanding the strengthening of the Canadian Dollar against its USD counterpart. The strengthening of the Canadian dollar during 2003 had a negative impact on the financial performance of Garneau amounting to approximately $2 million dollars as both large international orders were secured prior to the Canadian dollar value strengthening by over 15% during the course of 2003.

STRATEGIC DIRECTION

Senior Management at Garneau remains focused on the "Strategic Plan" for the Corporation, addressing the issues of surplus plant capacity, seasonality of our core business and overall profitability of the Corporation.

Strategic highlights for the year 2003 include:

- **Diversification**

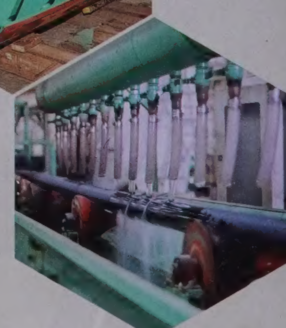
For 2003, the Corporation completed its first full year of production of HDPE with sales activity increasing in May 2003 and remaining active throughout the remainder of 2003.

Garneau's focus on servicing existing coating customers with reeled 2-6" pipe used for shallow gas wells continue and strong gas drilling forecasts for 2004 is projected to lead to further increased volumes of this product line.

- **Design and Manufacturing Capability**

Our international reputation as a leader in pipeline equipment manufacturing continues to grow with increased interest now being expressed in our innovative coating line equipment. Equipment for two international coating equipment contracts valued in excess of $8 million USD were manufactured and shipped during the course of the 2003 year. The plant that was erected in the town of Vostochny along the eastern Russian seaport is now fully operational and Garneau's Management Services Agreement ("MSA") is now effective for the duration of the 20 month project. This MSA represents the Corporation's first international coating contract in the estimated two billion dollar international coating industry.

The second coating equipment contract was shipped to Iran in mid summer and is now in the process of being erected and commissioned. Although both US dollar contracts were negatively impacted by the strengthening of the Canadian dollar during the course of 2003, increased Corporate exposure from successful operation of the coating plants in both Russia and Iran is projected to enhance Garneau's image as a leader in the design and operation of coating equipment. New opportunities are projected to arise internationally as exposure increases.



- **Innovative Technology and Flexibility**

During the course of 2003, the Corporation announced plans to incorporate a second coating line in the Camrose facility. Utilization of surplus coating equipment available from the Nisku facility together with a further capital investment of approximately $1 million enabled Garneau to have a second coating line fully operational effective January 26, 2004. This additional coating line will increase Garneau's overall coating capacity required for peak seasonal periods together with projected improvements to overall plant efficiency based on more effective plant scheduling and preventative maintenance programs.

The second coating line will also enable Garneau flexibility in pursuing future large diameter project work without interruption of our customers small diameter requirements.

OUTLOOK 2003

Our Sakhalin project is now entering into the MSA stage of the project which will contribute to our international project activity for 2004. Quoting activity internationally remains steady with potential projects being pursued on an ongoing basis. Domestic manufacturing opportunities are also projected to improve as additional client relationships are built by the Corporation.

Our core coating operations is projected to remain active during 2004 as Analysts estimate drilling activity to exceed 20,000 wells during the year, well above average historical results in recent years.

Initial 2004 small diameter coating activity has remained active with a back order book in line with Q1 of 2003. Further penetration of market share is projected to compliment increased drilling activity and contribute to our 2004 coating operation results.

The continued penetration with our existing coating customers during 2004 of our HDPE is projected to have a positive impact on 2004 operating results as market penetration is achieved in this segment of the line pipe industry.

Garneau Inc. is now progressing with attaining strategic objectives pertaining to diversification and expansion of manufacturing operations and we look forward to successful performances from these initiatives contributing to corporate profitability.

Sincerely,
Glen R. Garneau
President and CEO

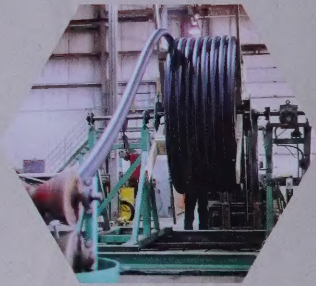
OPERATIONS

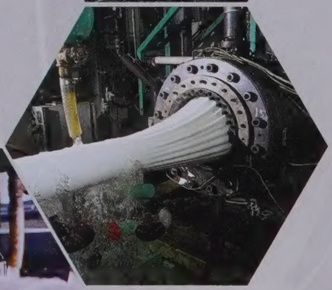
Garneau's Camrose facility operating usage increased during 2003, a direct result of an increase in small diameter coating activity.

Plant efficiencies and margins both improved during 2003 based on increased activity, although the quicker delivery demands placed on the Corporation during peak seasonal activity by our clients resulted in some inefficient plant scheduling which is expected to be rectified by start up of our second coating line in Camrose.

Garneau is now well prepared to handle both continuing small diameter customers' requirements and potential large diameter project work through the Corporation's two multiproduct coating lines.

Garneau's High Density Polyethylene Pipe production completed the first full year of operations with production speeds increasing towards full production capabilities. Product inventory between 2-6" is being produced for our existing energy clients.





A MANUFACTURING PERSPECTIVE

The manufacturing division focused on the fabrication for the two large International Contracts totaling in excess of $8 million USD during the first six months of 2003, with attention to the setup and commissioning of the coating plants required during the latter four months of 2003. The fabrication shop operated at capacity during the initial six months of 2003 with little capability to service the domestic manufacturing opportunities available.

Domestic fabrication projects activity increased over the latter four months of 2003 as shop space became available.

The Sakhalin coating plant is now operational and the Iranian coating plant is currently being erected on site. Both coating plants are considered to be highly automated and fully represent the capability of Garneau's engineering design group.

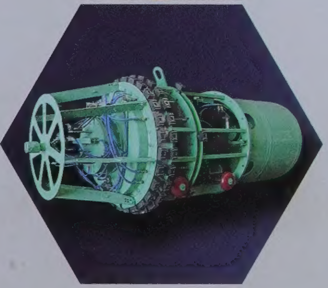
Further international exposure is projected to enhance Garneau's image as a fully integrated coating operation with the capabilities of:

- Coating plant engineering and design
- Coating plant fabrication and installation
- Coating plant operational capability for international projects

Garneau's over 30 year history internationally and technological advancement in coating plant and pipeline equipment design is now providing increased sales opportunities for the Corporation.

The flexibility of our engineering and design department remain intact and poised to facilitate additions to our existing line of equipment products.

Furthermore, the diversification of domestic manufacturing products is expected to contribute to the long-term growth of the Corporation's manufacturing division.



FOREIGN EXCHANGE RATE

The strengthening Canadian dollar during 2003 had a significant negative impact on Garneau financial performance for the year. Future success of our international business is partially contingent on a stable Canadian dollar to enable Garneau to compete globally for large international contracts. Steps have now been taken by Garneau to reduce the impact of foreign exchange fluctuations on operating performance in the future.

RESULT OF OPERATIONS

This report includes forward-looking statements that are based on the Corporation's current expectations and therefore are subject to uncertainties such as the level of industry drilling and coating activity, foreign exchange fluctuations and worldwide economics conditions that may cause actual results to differ materially.

Revenues

Consolidated revenues for the fourth quarter ended December 31, 2003 totaled $11.3 million with total consolidated revenues increasing by 162% for the year ended December 31, 2003; totaling $45.0 million compared to $17.2 million for the year ended December 31, 2002. An increase in domestic oilfield activity resulted in increased coating activity, which together with a substantial increase in international fabrication orders resulted in higher 2003 revenue.

Pipeline revenue totaled $9.2 million for the fourth quarter ended December 31, 2003. Pipeline revenue totaled $26.4 million for the year ended December 31, 2003 and pertains primarily to small diameter coating work and accessory sales there from. This represents a 92.7% increase over the $13.7 million in pipeline revenue recorded for the year ended December 31, 2002.

Manufacturing revenue for the fourth quarter ended December 31, 2003 totaled $2.3 million. Manufacturing revenues totaled $18.6 million for the year ended December 31, 2003 a substantial increase over the $3.5 million recorded for the year ended December 31, 2002. International equipment orders included in manufacturing revenue totaled $16.9 million with the remaining $1.7 million generated from domestic fabrication.

Gross Margin

The Corporation's gross margin for the fourth quarter ended December 31, 2003 totaled $3.4 million with the Corporation's gross margin totaling $8.6 million (19.0%) for the year ended December 31, 2003 compared to $3.1 million (17.8%) for the year ended December 31, 2002. Increased domestic coating volumes and large international orders contributed to the increased gross margin, however the percentage was negatively impacted by the foreign exchange fluctuation during the year.

The Pipeline division gross margin totaled $3.1 million (33.7%) for the fourth quarter ended December 31, 2003. The Pipeline division gross margin of $6.8 million (25.8%) reflects improved efficiencies on plant operations based on increased volumes of small diameter coating activity. The pipeline gross margin increased by $4.7 million over the $2.1 million recorded at December 31, 2002.

The manufacturing division gross margin totaled $0.3 million (13.4%) for the fourth quarter ended December 31, 2003. The manufacturing division gross margin of $1.7 million (9.2%) is $0.7 million higher than the $1.0 million gross margin recorded for the year end December 31, 2002. However, the 9.2% in gross margin is lower than the 27.5% recorded at December 31, 2002 and is attributed to lower margins attained on two large international projects. These lower margins were primarily caused by the strengthening of the Canadian dollar during 2003.

Expenses

Selling, general and administrative expenses for the fourth quarter ended December 31, 2003 totaled $938 thousand with selling, general, and administrative expenses totaling $3.7 million (8.2% of revenue) for the year ended December 31, 2003, as compared to the $3.2 million (18.5% of revenue) for 2002. The $0.5 million increase in selling, general and administrative expenses is attributed to the increased sales activity during the Corporation's operations of 2003, and further upward pressure on insurance and wages expenses during the year.

The Corporation continues to calculate amortization of its coating equipment based on utilization, better matching revenues generated by the equipment. The balance of the Corporation's property, plant and equipment is amortized on a straight-line basis. Total amortization of $629 thousand was recorded for the fourth quarter ended December 31, 2003 with amortization totaling $2.3 million for the year ended December 31, 2003, representing 5.1% of revenue compared to $2.3 million for the year ended December 31, 2002 representing 13.2% of revenue.

The Corporation has an active research and development department, continuously striving for improvements in products, processes, and equipment design. Research and development expenses totaled $207 thousand at December 31, 2003, a $19 thousand decrease over the $226 thousand recorded for the comparative period ended December 31, 2002.

Manufacturing expenses totaled $0.5 million for the fourth quarter ended December 31, 2003. Manufacturing expenses totaled $2.0 million for the year ended December 31, 2003 an increase of $0.8 million over of the $1.2 million recorded for the period ended December 31, 2002. The manufacturing division's overhead costs increased primarily due to support services and expenses incurred on the completion of the two major international contracts.

The Pipeline division expenses totaled $1.4 million for the fourth quarter ended December 31, 2003. The Pipeline division expenses total $5.1 million for the year ended December 31 2003 an increase of $0.5 million over the $4.6 million for the year ended December 31, 2002.

Foreign exchange losses totaled $376 thousand for the year ended December 31, 2003 and are attributed to continued strengthening of the Canadian dollar during the course of 2003 and the negative impact on US dollar cash holdings of the Corporation. In addition to foreign exchange recorded totaling $376 thousand at December 31, 2003, the negative impact on the Corporation from the strengthening of the Canadian dollar also resulted in excess of $1.5 million of reduced revenue and margins on the two major international contracts completed during the year, calculated from the difference in exchange rates from the date of contract to receipt of proceeds.

Interest costs totaled $619 thousand for the year ended December 31, 2003, an increase of $318 thousand over the $301 thousand recorded for the year ended December 31, 2002. This increase is attributed to project financing required to complete the two major international projects sold during the 2003 year.

Operating Income

An operating income of $1.8 million was recorded for the fourth quarter ended December 31, 2003. An operating income of $2.4 million was recorded for the year ended December 31, 2003; an increase of $4.9 million over the $2.6 million operating loss recorded for the year ended December 31, 2002. Increased revenue and margins therefrom for both the Pipeline and Manufacturing divisions contributed to the improved operating performance of the Corporation.

Earnings (loss)

Net earnings for the fourth quarter ended December 31, 2003 totaled $1.5 million. A net earnings of $1.4 million was recorded for the year ended December 31, 2003 compared to a net loss of $2.8 million recorded for the year ended December 31, 2002. This $4.2 million increase is attributed to increased revenues, and improved plant efficiencies achieved from increased small diameter coating volumes experienced during the year.

A Manufacturing division loss of $0.2 million was recorded for the fourth quarter ended December 31, 2003. Manufacturing division losses for the year ended December 31, 2003 totaled $0.3 million, directly attributed to the negative impact of the strengthening Canadian dollar on international project margins. The negative impact on margins and overall Manufacturing division profitability due to the strengthening of the Canadian dollar from the date of contract commencement totaled in excess of $2.0 million for the year ended December 31, 2003.

Pipeline divisional earnings totaled $1.8 million for the fourth quarter ended December 31, 2003, primarily attributed to the significant increase in small diameter coating volumes. Pipeline divisional earnings for the year ended December 31, 2003 totaled $1.8 million that reflects the increased revenue from small diameter coating and improved plant efficiencies based on increase coating volumes.

Liquidity and Capital Resources

At December 31, 2003, operating and term loan credit facilities available to the Corporation included a demand revolving operating line of credit of $6.3 million, a demand revolving evergreen loan of $3.0 million, a capital lease loan facility for $1.3 million pertaining to the manufacture of polyethylene pipe and term loans in the amount of $6.2 million.

The Corporation has a $6.3 million operating line of credit available for operating uses. The evergreen term loan was not fully drawn upon at December 31, 2003, and has $0.1 million available to finance 100% of future capital expenditures, compared to $0.3 million available at December 31, 2002. The term loan facility available for polyethylene pipe has been drawn on by way of capital lease with HSBC Bank Canada in the amount of $1.3 million.

Additions to capital equipment were $3.3 million for the year ended December 31, 2003, compared to $1.3 million for year ended December 31, 2002. Capital expenditures for 2003 were primarily related to the purchase of the Nisku facility used for the Corporation's head office, manufacturing operations equipment costs incurred on the polyethylene pipe manufacturing line, a second extrusion coating line in the Camrose plant, additional fabrication, mobile and coating equipment improvements required during the year ended December 31, 2003.

Loans payable at December 31, 2003 total $6.6 million. The bank's working capital covenants have been adjusted to remove principal payments due after 12 months from the working capital covenant calculation. Working capital of negative $2.2 million is recorded at December 31, 2003. The adjusted working capital, calculated by deducting $5.3 million of loans payable scheduled to be repaid after 12 months, totals $3.1 million.

Loans payable and capital lease obligations at December 31, 2003 totaled $7.7 million, an increase of $1.2 million over the $6.5 million recorded at December 31, 2002. This increase is primarily attributed to the purchase and financing of the Nisku head office land and buildings. The Corporation continues to draw on available term debt credit facilities to finance capital asset purchases with repayment in accordance with existing bank agreements. All bank covenants were met at December 31, 2003.

Cash generated from operations prior to changes in working capital, for the fourth quarter ended December 31, 2003 totaled $2.2 million. Cash generated from operations, prior to changes in working capital, was $3.7 million for the year ended December 31, 2003, an increase of $4.3 million over the $0.6 million used in the year ended December 31, 2002. The increase reflects cash generated from net earnings generated from increased activity for the year.

MANAGEMENT DISCUSSION AND ANALYSIS

Selected Annual Information

Year Ended	December 31, 2003	December 31, 2002	December 31, 2001
Total Revenues	$44,955	$17,187	$29,320
Net Earnings	1,403	(2,753)	1,971
Basic Earnings per Share	0.12	(0.24)	0.18
Diluted Earnings per Share	0.12	(0.24)	0.18
Total Assets	37,121	26,720	30,255
Long Term Capital Lease Obligations	712	981	697

Increased small diameter coating activity and large international project work contributed to the significant increase in revenue and net earnings. The increased revenue generated also resulted in increased accounts receivables outstanding during the course of 2003.

Selected Quarterly Information

	Three Months Ended							
	Dec.31/03	Sept.30/03	June.30/03	Mar.31/03	Dec.31/02	Sept.30/02	June.30/02	Mar.31/02
Total Revenues	$11,326	$7,793	$13,305	$12,531	$3,844	$2,955	$2,691	$7,697
Net Earnings (Losses)	1,529	(308)	(1,119)	1,301	(1,184)	(1,228)	(1,448)	1,107
Basic Earnings per Share	0.14	(0.03)	(0.10)	0.12	(0.11)	(0.11)	(0.13)	0.10
Diluted Earnings per Share	0.13	(0.03)	(0.10)	0.11	(0.11)	(0.11)	(0.13)	0.09
Total Assets	37,121	35,009	37,419	33,065	26,720	26,720	24,721	29,001
Long Term Capital Lease Obligations	712	685	785	899	981	981	602	653

The seasonality of the pipe coating business results in wide quarterly fluctuations in revenue generated by the Corporation and net earnings (losses) therefrom. The second quarter ended June 30 is historically the slowest period for the Corporation with the March 31 quarter the most active. Losses occurred in the periods June 30, 2003 and September 30, 2003 as margins on large international contracts in progress were negatively impacted by the strengthening Canadian dollar.

New Accounting Policies

The Canadian Institute of Chartered Accountants has adopted new recommendations with respect to stock based compensation, asset retirement obligations and impairments of long-lived assets that may impact the Corporation in 2004. These recommendations are currently being assessed for their potential impact on the Corporation's financial reporting and will be adopted, as appropriate, in the first quarter of 2004.

Critical Accounting Estimates

The Corporation recognizes revenues related to equipment fabrication contracts based on the percentage of completion of the individual contracts. At December 31, 2003, all significant fabrication contracts were substantially complete.

The Corporation provides an estimate for depreciation of assets based on expected useful life of the assets with coating and extrusion equipment calculated based on utilization of the equipment to match revenues generated by the equipment.

Disclosure of Contractual Obligations

The following schedule represents contractual obligation payments required to be made by the Corporation.

	Total 2004	2005	2006	2007	2008 and beyond
Loans Payable	$1,341	$990	$990	$891	$2,386
Capital Lease Obligations	413	260	301	203	18
Operating Lease	264	171	121	46	

Please refer to notes 4(a) and (b) of the Financial Statements for further details.

BUSINESS RISKS

Capital spending by pipeline transmission and oil and gas companies drives the demand for Garneau Inc.'s coating products. The Corporation's continued success is fundamentally linked to the continued growth and stability of the energy industry, both domestically and internationally. In addition, Garneau Inc.'s future success depends upon the continued expansion of equipment fabrication, increasing its market share of pipe coating services in Canada and further diversification. Other uncertainties in the industry include domestic and foreign government policies and regulations, foreign exchange rates, and world energy prices.

Furthermore, the Corporation has one major competitor in the Pipeline business segment that has significant market share and influence over product pricing which could impact future corporate performance. Small diameter coating activity for the Corporation is directly dependant on drilling activity in the industry which has historically shown significant fluctuations from year to year.

The Manufacturing business segment is primarily dependant on the Corporation's ability to secure large project work internationally, which has inherent risks associated with the fluctuation of foreign exchange rates, together with economic and political risks of foreign countries. The Corporation will consider hedging and other products designed to mitigate the impact of foreign exchange fluctuation on future contracts obtained.

OUTLOOK

2003 results directly reflects the increase in domestic oilfield activity and in particular, increased drilling activity and small diameter coating demand there from.

2003 results were also impacted by the Corporation's success in obtaining two large international coating equipment contracts.

The combination of increased small diameter coating activity and successful award of the two large international contracts resulted in a record revenue year for the Corporation totaling $45 million. The Corporation returned to operating profitability for the 2003 year, despite the untimely strengthening of the Canadian dollar and substantial impact on the gross margins of the large international projects.

The Corporation remains active internationally in pursuing pipe handling and coating equipment orders, although the competitiveness of future bids may be affected by the Canadian dollar and further foreign exchange rate fluctuations. Garneau is now entering the Management Services Agreement stage of our agreement for the Russian plant which will provide the Corporation with further recognition and exposure as a provider of coating services worldwide.

Furthermore, based on continued strong energy prices and capital budget forecasts provided by energy companies for 2004, drilling and well completion activity is projected to exceed 20,000 wells in 2004. Small diameter coating activity at Garneau has shown signs of improvement in the first quarter of 2004 and is projected to contribute to operating results for the Corporation for 2004.

Management is of the opinion that achieving controlled growth outlined in the Corporation's Strategic Plan will result in sufficient working capital being generated from operations. This working capital, together with external financing, is projected to meet the Corporation's liabilities and commitments as they become payable. Future operations will remain dependant on the Corporation's ability to generate sustainable profits.

Diversification into the manufacturing of polyethylene pipe in our Camrose coating plant contributed to improve revenue results in 2003 and is projected to contribute further to operating results in 2004.

Recent completion of a second small diameter coating line in Camrose will enable the Corporation to increase coating capacity in the busy winter season together with the projected improvement of plant efficiencies and scheduling. The Corporation is now able to participate in a broader range of oil and natural gas projects in both small and large diameter pipe. The doubling of the Corporation's coating capacity at the Camrose Plant, combined with the expansion of services into the large diameter market, solidifies management's belief that the Corporation is well positioned to increase its domestic market share over the long term, although no large diameter projects are scheduled thus far for 2004.

Garneau will continue to invest in research and development, while actively pursuing potential new markets and focusing on profitable growth by offering specialty products and services to complement our core coating and manufacturing operation.

Operating profitability during fiscal 2004 will remain the primary focus of the Corporation, requiring management to continue to control infrastructure costs as new revenue sources cultivate during the projected continued active domestic industry.

Edmonton, Canada
February 20, 2004

MANAGEMENT'S RESPONSIBILITY TO THE SHAREHOLDERS

The accompanying consolidated financial statements and other financial information included in Garneau Inc.'s Annual Report are the responsibility of the management of Garneau Inc. and have been approved by the Board of Directors.

The financial statements have been approved by management, and are prepared in conformity with Canadian generally accepted accounting principles. The financial statements include estimates based on the experience and judgment of the management in order to ensure that the financial statements are presented fairly in all material respects. Financial information presented elsewhere in this Annual Report is consistent with that in the financial statements.

The management of the Corporation developed and continues to maintain systems of internal accounting controls and management practices designed to provide reasonable assurance that the financial information is relevant, reliable, and accurate. In addition, programs of proper business conduct and risk management are implemented to protect the Corporation's assets and operations and to give reasonable assurance that transactions are properly authorized, assets are guarded from loss or misuse and financial records are maintained to provide reliable financial information for preparation of financial statements.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control, with the assistance of the Audit Committee. The Board appoints the Audit Committee, whose members are Directors that are not corporate officers. This committee meets periodically with management and the Corporation's external auditors to discuss audit examinations, internal control, accounting policy and financial reporting matters.

The Audit Committee also reviews with management the annual and quarterly consolidated financial statements of the Corporation prior to submission to the Board of Directors for final approval. The external auditors have full and unrestricted access to the Audit Committee. The Audit Committee recommends a firm of external auditors, to be appointed by the shareholders. KPMG LLP has been appointed the external auditors of the Company to provide an independent professional opinion on the annual consolidated financial statements. The Auditors' Report to the shareholders is also presented in this Annual Report.

Sincerely,

Glen R. Garneau
President, CEO

Frank Deys
Chief Financial Officer

Edmonton, Canada
February 20, 2004

AUDITORS' REPORT TO THE SHAREHOLDERS OF GARNEAU INC.

We have audited the consolidated balance sheets of Garneau Inc. as at December 31, 2003 and 2002 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

KPMG LLP

Edmonton, Canada
February 20, 2004

(In thousands)	at December 31, 2003	at December 31, 2002
Assets		
Current Assets:		
Cash	$ 1,414	$ —
Accounts receivable	11,376	3,682
Inventory	3,336	2,625
Prepaid expenses and deposits	101	91
	16,227	6,398
Property, plant and equipment (note 3)	20,894	20,322
	$ 37,121	$ 26,720
Liabilities and Shareholders' Equity		
Current Liabilities:		
Operating Loan (note 2)	$ 6,726	$ 1,379
Accounts payable and accrued liabilities	4,746	2,263
Loans payable (note 4(a))	6,598	5,217
Current portion of capital lease obligations	362	315
	18,432	9,174
Capital lease obligations (note 4(b))	712	981
	19,144	10,155
Shareholders' Equity:		
Share capital (note 5)	20,727	20,718
Deficit	(2,750)	(4,153)
	17,977	16,565
Commitments (note 6)		
	$ 37,121	$ 26,720

The accompanying notes are an integral part of these consolidated financial statements.

On behalf of the Board:

Dan Motyka
Director

Michael Lang
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

(In thousands except per share data)	Year Ended December 31, 2003	Year Ended December 31, 2002
Revenue	$ 44,955	$ 17,187
Operating costs	36,404	14,121
	8,551	3,066
Other operating expenses (income):		
Selling, general and administrative	3,665	3,187
Amortization	2,324	2,283
Research and development	207	226
Bad debts	3	28
Gain on disposal of property, plant and equipment	(6)	(106)
	6,193	5,618
Operating income (loss)	2,358	(2,552)
Financing:		
Interest on loans payable	387	274
Interest on operating loans	232	27
Other	—	(32)
Foreign exchange losses	376	—
Other income	(80)	(88)
Earnings (loss) before income taxes	1,443	(2,733)
Income taxes (note 7):		
Current	40	20
	40	20
Net earnings (loss)	1,403	(2,753)
Deficit, beginning of year	(4,153)	(1,400)
Deficit, end of year	$ (2,750)	$ (4,153)
Earnings (loss) per share (note 5):		
Basic	$ 0.12	$ (0.24)
Diluted	$ 0.12	$ (0.24)

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Year ended December 31, 2003	Year ended December 31, 2002
Cash provided by (used in):		
Operations (note 10):		
Net earnings (loss)	$ 1,403	$ (2,753)
Items not involving cash:		
Amortization	2,324	2,283
Gain on disposal of property, plant and equipment	(6)	(106)
	3,721	(576)
Changes in non-cash operating working capital	(5,932)	841
	(2,211)	265
Financing:		
Proceeds from exercise of share purchase options	9	—
Repayment of loans payable and capital leases	(7,381)	(2,793)
Increase (decrease) in operating loan	5,347	1,379
Advances under term loan	8,540	1,600
Proceeds from sale and lease-back of assets	104	610
	6,619	796
Investments:		
Proceeds from disposal of property, plant and equipment	269	115
Additions to property, plant and equipment	(3,263)	(1,297)
	(2,994)	(1,182)
Increase (decrease) in cash	1,414	(121)
Cash, beginning of year	—	121
Cash, end of year	$ 1,414	$ —

The accompanying notes are an integral part of these consolidated financial statements.

The Corporation is incorporated under the Business Corporations Act of Alberta. Its principal business activities are the manufacturing for and coating of pipelines in the oil and gas industry.

In the notes to the consolidated financial statements, all dollar amounts are stated in thousands of Canadian dollars, except share data, unless otherwise indicated.

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of presentation:

These consolidated financial statements include the accounts of the Corporation and its subsidiaries.

These consolidated financial statements have been prepared assuming that future operations will allow for the realization of assets and discharge of liabilities in the normal course of business. Management is of the opinion that sufficient working capital will be obtained from operations to meet the Corporation's liabilities and commitments as they become payable. These consolidated financial statements do not include any adjustments to the carrying value of assets and liabilities that might be necessary should the Corporation not continue operating in the normal course of business.

(b) Measurement Uncertainty:

The preparation of the financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. In determining estimates of the estimated useful lives and net recoverable amounts for property, plant and equipment, the Corporation relies on assumptions regarding applicable industry performance and prospects, as well as general business and economic conditions that prevail and are expected to prevail. Assumptions underlying asset valuations are limited by the uncertainty of predictions concerning future events. By nature, asset valuations are subjective and do not necessarily result in precise determinations. Actual results could differ from those estimates.

(c) Recognition of revenue:

Revenue from product sales is recognized at the date of shipment to the customer.

Revenue related to the coating of pipe is recognized as the pipe is processed.

Revenue related to equipment fabrication contracts is recognized based upon the percentage of completion of the individual contracts. Amounts billed in excess of amounts recognized are deferred. Any significant anticipated losses on contracts in progress are provided for as soon as they become evident.

(d) Inventory:

Raw materials are stated at the lower of cost and replacement cost. Work in progress and finished goods are valued at the lower of cost and net realizable value.

(e) Foreign exchange:

Monetary assets and liabilities denominated in foreign currencies are translated at prevailing rates of exchange at the balance sheet date. Revenue and expenses are translated at the exchange rates prevailing on the transaction date. Realized and unrealized exchange gains and losses are included in earnings.

The operations of a wholly owned subsidiary, which is deemed to be an integrated foreign operation, are translated using the temporal method. Under this method, all monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date and all non-monetary assets and liabilities are translated using the exchange rates in effect when the balance originated. Revenues and expenses are translated at the average exchange rate prevailing during the year. Translation gains and losses arising from changes in exchange rates are included in the determination of earnings for the year.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Stock-based compensation plan:

The Corporation accounts for all stock-based compensation granted to directors, officers and employees using the intrinsic value method. No compensation cost is recorded for these awards. The Corporation discloses the proforma effect of accounting for these awards under the fair value based method. (see Note 5(c)).

(g) Property, plant and equipment:

Property, plant and equipment are stated at cost. Amortization is provided using the straight-line method at the following annual rates:

Asset	Rate
Land improvements	5%
Buildings and extrusion plant	5% - 6.25%
Machinery and equipment	6.25% - 33%
Leasehold improvements	20%
Rental equipment	12.5%

Equipment under capital lease is amortized using the same rates as similar assets.

The amortization method for coating equipment and the extrusion plant correlates amortization with utilization of the equipment to match revenues generated by the equipment. It is not anticipated that this method will extend the period over which the equipment will be amortized.

(h) Income Taxes:

The Corporation uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

2. OPERATING LOAN

At December 31, 2003, the Corporation had available a demand revolving operating loan of $6,250. As collateral for this loan and loans payable (note 4), the Corporation has provided a general security agreement creating a first charge over all assets, collateral mortgages of $8,400 over the Corporation's land and buildings, and assignments of insurance.

The operating loan bears interest at the lender's prime rate for Canadian and United States dollar borrowings. Interest is paid monthly. The amount available under the operating loan is subject to a borrowing base formula applied to the levels of accounts receivable and inventories.

Letters of guarantee and credit for performance and bid guarantees, when issued, reduce the amount available for borrowing under the operating loan. Letters of Credit for $316 and $35, expiring July, 2004 were outstanding at December 31, 2003.

3. PROPERTY, PLANT AND EQUIPMENT

2003 (In thousands)	Cost	Accumulated amortization	Net book value
Land and land improvements	$ 4,288	$ 1,384	$ 2,904
Buildings and extrusion plant	5,534	1,219	4,315
Machinery and equipment	21,457	9,366	12,091
Leasehold improvements	264	255	9
Rental equipment	832	577	255
	32,375	12,801	19,574
Equipment under capital lease	1,932	612	1,320
	$ 34,307	$ 13,413	$ 20,894

2002 (In thousands)	Cost	Accumulated amortization	Net book value
Land and land improvements	$ 3,398	$ 1,229	$ 2,169
Buildings and extrusion plant	5,875	983	4,892
Machinery and equipment	19,329	7,825	11,504
Leasehold improvements	264	249	15
Rental equipment	794	513	281
	29,660	10,799	18,861
Equipment under capital lease	1,883	422	1,461
	$ 31,543	$ 11,221	$ 20,322

4 (a). LOANS PAYABLE

(In thousands)		2003	2002
1.	Demand bank loan	$ —	$ 267
2.	Vendor back mortgage interest only, payable monthly with principal due in full May 1, 2004. . Interest is charged at 6%.	350	—
3.	Demand evergreen bank loan, payable in monthly principal installments of $60. Interest is charged at the rate of bank prime plus 0.875%, secured as described in note 2.	2,948	2,500
4.	Demand bank loan, payable in monthly principal installments of $23. Interest is charged at the rate of bank prime plus 0.875%, secured as described in note 2.	3,300	2,450
		$ 6,598	$ 5,217

The evergreen bank loan is for financing the cost of capital upgrades and is limited to the lesser of 100% of the total cost of upgrades and $3,000.

4 (a). LOANS PAYABLE (CONTINUED)

Loans payable to the Corporation's bank are payable upon demand and are classified as a current liability. Scheduled repayments are as follows:

2004	**$**	**1,341**
Total scheduled repayments due within 12 months		1,341
2005	$	990
2006		990
2007		891
2008		436
And subsequent years		1,950
Total scheduled repayments due after 12 months	$	5,257

4 (b). CAPITAL LEASE OBLIGATIONS

The Corporation has financed certain equipment by entering into capital leasing arrangements. Capital lease repayments are due as follows:

		2003		2002
2003	$	—	$	391
2004		413		397
2005		260		239
2006		301		279
2007		203		180
2008		18		—
Total minimum lease payments		1,195		1,486
Less amount representing interest at rates ranging from 6% to 8%		121		190
Present value of capital lease payments		1,074		1,296
Current portion of capital lease obligations		362		315
	$	712	$	981

5. SHARE CAPITAL

(a) Authorized:
Unlimited number of common shares.

(b) Issued:

	Number of Shares		$ Value (In $000)
Common Shares outstanding at December 31, 2001 and 2002	11,245,277	$	20,718
Issued for cash during 2003 on exercise of options	14,600	$	9
Common shares outstanding at December 31, 2003	11,259,877	$	20,727

(c) Options:
The Corporation has implemented a stock option plan for directors, officers, employees and consultants and reserved 1,300,000 common shares for the plan. The exercise price of the share purchase options reflects the market price of the shares at the date the options were granted.

5. SHARE CAPITAL (CONTINUED)

A summary of the status of the Corporation's stock option plan as of December 31, 2003 and 2002, and changes during the years ended, on those dates is presented below:

	2003		2002	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,014,250	$ 0.73	551,250	$ 1.61
Granted	208,150	$ 0.60	722,500	$ 0.57
Exercised	(14,600)	$ 0.60	—	—
Cancelled	(3,000)	$ 0.60	(259,500)	$ 2.15
Outstanding at end of year	1,204,800	$ 0.71	1,014,250	$ 0.73
Options exercisable at end of year	959,842	$ 0.72	685,647	$ 0.74

The following options are outstanding as of December 31, 2003:

Number of Shares			
Granted	Vested	Expiry date	Exercise Price per Share
20,000	20,000	March 2, 2004	$ 1.69
14,000	14,000	August 31, 2004	$ 2.67
17,750	17,750	September 13, 2004	$ 2.54
200,000	166,667	May 15, 2006	$ 0.90
40,000	20,000	June 28, 2006	$ 0.79
522,500	501,875	February 22, 2007	$ 0.56
200,000	50,000	September 18, 2007	$ 0.61
190,550	169,550	January 30,2008	$ 0.60
1,204,800	959,842		

When the Corporation awards stock options, no compensation cost is recognized in the consolidated statement of operations for common share options granted. Had compensation costs been recognized on the basis of fair values at the grant date for those options, the Corporation's net earnings (loss) and earnings (loss) per share would have been reduced to the amounts below:

Year ended	December 31, 2003	December 31, 2002
Compensation costs	$ 69	$ 125
Net earnings (loss):		
As reported	1,403	(2,753)
Pro forma	1,334	(2,878)
Basic earnings (loss) per share:		
As reported	0.12	(0.24)
Pro forma	0.11	(0.26)
Diluted earnings (loss) per share:		
As reported	0.12	(0.24)
Pro forma	0.11	(0.26)

The pro forma disclosures do not include the effect of options granted before January 1, 2002.

The fair value of stock options granted is estimated at the grant date using the Black-Scholes option pricing model using the following assumptions:

Year ended	December 31, 2003	December 31, 2002
Dividend yield	—	—
Risk-free interest rate	4.5%	6%
Expected life	5 yrs	5 yrs
Expected volatility	35%	35%

5. SHARE CAPITAL (CONTINUED)

(d) Employee Ownership Plan

The Corporation has an Employee Share Ownership Plan in place under which employees may contribute 3% of eligible compensation each year to purchase common shares of the Corporation. The Corporation will match the employee contribution and the Corporation's contribution vests on December 31 of each year. If the Corporation wishes, it is authorized to issue up to 1,000,000 common shares under the Plan.

At December 31, 2003, 23 employees were participating under the Plan. Employee and Corporation contributions for 2003 totaled $78 and were used to purchase, 102,697 common shares of the Corporation on the open market.

(e) Earnings (loss) per Share:

The computations for basic and diluted earningsper share are as follows:

(In thousands except per share value)	2003	2002
Net earnings (loss)	$ 1,403	$ (2,752)
Weighted average number of common shares outstanding:		
Basic	11,251	11,245
Effect of stock options	894	—
Diluted	12,145	11,245
Earnings (loss) per share:		
Basic	$ 0.12	$ (0.24)
Diluted	$ 0.12	$ (0.24)

6. COMMITMENTS

The Corporation is committed to operating lease payments for premises, automobiles, mobile and office equipment in the following approximate amounts:

2004	$ 264
2005	171
2006	121
2007	46

7. INCOME TAXES

Income tax expense differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rate of 36.6% (2002-39.1%) to income before income taxes. The reasons for the differences are as follows:

(in thousands)	2003	2002
Expected income taxes (recovery) at basic rate	$ 528	$ (1,069)
Increase (decrease) resulting from:		
Manufacturing and processing deduction	(25)	93
Other amounts	130	168
Change in valuation allowance	(593)	828
	$ 40	$ 20

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities are presented below:

	2003	2002
Future tax assets:		
Losses carried forward (expiring up to 2009)	$ 1,651	$ 1,974
Other	265	155
	1,916	2,129
Less valuation allowance	(416)	(1,009)
	1,500	1,120
Future tax liabilities:		
Property, plant and equipment – excess of net book value over undepreciated capital cost	1,500	1,120
	1,500	1,120
Net future tax liability	$ —	$ —

8. FINANCIAL INSTRUMENTS

(a) Market risks:

The Corporation operates internationally, giving rise to exposure to market risks from changes in interest rates, foreign exchange rates and commodity prices.

(b) Concentrations of credit risk:

Substantially all the Corporation's accounts receivable are with companies in the oil and gas industry in Western Canada and with a single international customer in the Corporation's manufacturing segment.

(c) Fair value:

The fair values of cash, accounts receivable, bank indebtedness and accounts payable and accrued liabilities approximate their carrying values due to the relatively short periods to maturity. The fair values of the loans payable, capital leases and letters of guarantee and credit are not significantly different from their carrying values.

9. SEGMENT DISCLOSURES

Management has determined that the Corporation operates in two reportable business segments which were Manufacturing and Pipeline. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

	Year ended December 31, 2003		Year ended December 31, 2002	
	Manufacturing	Pipeline	Manufacturing	Pipeline
Revenue	$ 18,579	$ 26,376	$ 3,452	$ 13,735
Gross margin	1,703 (9.2%)	6,848 (26.0%)	952 (27.5%)	2,114 (15.4%)
Other expenses	2,036	5,072	1,207	4,592
Earnings (Loss) before income taxes	(333)	1,776	(255)	(2,478)

Substantially all of the carrying value of the property, plant and equipment and amortization expense relate to the Pipeline segment.

The Corporation had 3 Customers with sales amounting to 10% or more of consolidated revenues during the year ended December 31, 2003. These 3 Customers accounted for 27%, 17% and 10% of consolidated revenues respectively. Export sales, primarily from sale of pipe coating and handling equipment, totaled $16.9 million (2001-$2.8 million).

10. INTEREST AND INCOME TAXES PAID AND INTEREST RECEIVED

	Year Ended	
	December 31, 2003	December 31, 2002
Interest paid	$ 619	$ 301
Income taxes paid	$ 31	$ 40
Interest received	$ 15	$ —

CORPORATE INFORMATION

DIRECTORS

Glen Garneau
Chairman,
President and Chief Executive Officer

Chris Garneau
Vice-President,
Manufacturing

John W. Carruthers[1,2,3]
Vice President,
Northern Development,
Enbridge Inc.

Michael J. Lang[1,2]
Chairman,
StoneBridge Merchant Capital Corp.

Daniel R. Motyka[1,2,3]
President,
Questor Technology Inc.

1 Member of Audit Committee
2 Member of Compensation Committee
3 Corporate Governance Committee

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Chairman,
President and Chief Executive Officer

Chris Garneau
Vice President,
Manufacturing

Frank Deys, CMA
Chief Financial Officer

Jay P. Reid
Corporate Secretary

REGISTRAR AND TRANSFER AGENT

Olympia Trust Company
Edmonton, Alberta

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STOCK EXCHANGE

TSX

SYMBOL

GAR

NOTICE OF ANNUAL GENERAL MEETING OF SHAREHOLDERS

Thursday, May 20, 2004
Time: 3:00 p.m.
The Westin Hotel
320 - 4th Avenue SW
Calgary, Alberta
T2P 2S6

GARNEAU INC. WEB SITE

http://www.garneau-inc.com